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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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The Process Of Repairing . . .

Although the business expansion will soon reach its second birthday, only limited improvements have been made so far in the state of corporate finances. While some progress has been achieved in restoring corporate financial health—after a period of almost nonstop deterioration since the mid-1970s—the lengthy process of repairing badly worn balance sheets has been repeatedly interrupted this year by rising interest rates and the frequent bouts of disarray plaguing the bond and stock markets. As a result, corporate America remains almost as vulnerable today to abrupt swings in the availability and cost of short-term credit as it did a year and a half ago. And despite a hefty increase in internal funds generated, interest expense continues to gobble up a good-sized chunk of business cash flow. Indeed, in the absence of more pronounced balance sheet improvements in the months ahead, business could find itself ill-prepared to weather any pause in today's economic expansion.

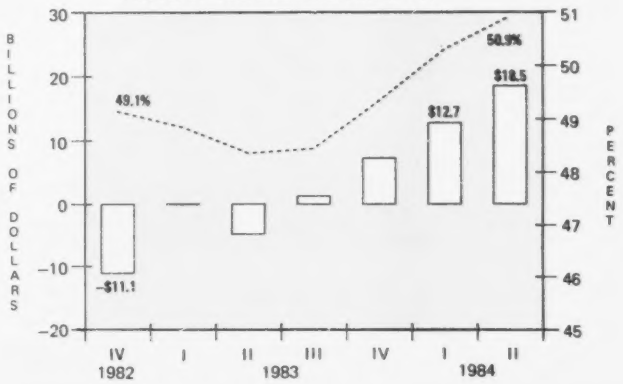
To be sure, corporate profits have snapped back strongly during this business expansion. With sales rising robustly, operating costs slashed, productivity improving and idle capacity either diminished or eliminated altogether, pre-tax corporate earnings rose by just about 60 percent over the past six calendar quarters. This is twice the rate of rise in before-tax earnings posted during the first 18 months of recovery from the preceding six postwar recessions. After-tax earnings have soared as well. They surged by more than $50 billion, or 52 percent during the same period—twice the rate of gain in the past. What is more, not only have the top-line numbers improved but, with inflation-driven inventory profits reduced and depreciation allowances enhanced, the "quality" of earnings has improved as well (Financial Digest—August 6, 1984).

The combination of escalating earnings and a sharp upturn in depreciation allowances stemming from the Economic Recovery Tax Act of 1981 has resulted in a sizable rise in overall business cash flow. It ran at a $325 billion annual rate during the second quarter of 1984, 22 percent above year-earlier levels and equivalent to nearly nine percent of GNP. This, too, is well ahead of previous cyclical experience; at this stage of the business cycle in the past, cash flow was usually running at a rate equivalent to about 7½ percent of GNP.

. . . Corporate Balance Sheets . . .

In light of such earnings and cash flow numbers, one would think that there is little cause for concern over the health of corporate finances—especially when compared with the bleak days of 1981-82. At that time, earnings were in the midst of one of their steepest slides in the postwar era, and business failures were running at postwar record rates, both in actual number, and when expressed as a percentage of the number of existing firms. And while there has been some improvement this year, in recent months, several of the nemeses which have plagued corporate America in the past once again threaten to bring to a halt the gains which have occurred to date.

CHANGE IN SHORT-TERM BUSINESS CREDIT OUTSTANDING (BAR) VS. SHORT-TERM LIABILITIES AS A % OF TOTAL LIABILITIES (DOT)



Perhaps most important, with the pace of business now tapering off, it appears a good bet that the high-water mark for corporate earnings gains during this business expansion has been reached. Already, the quarter-over-quarter rise in earnings has begun to slow. However, the pace of outlays for inventories and capital equipment remains strong. As a result, the corporate "surplus" which prevailed throughout much of 1983—when cash flow far outstripped spending for inventories, plant and equipment—has vanished, suggesting that business may soon return to external sources for funds. Nor is this situation expected to

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change anytime soon, especially as long as today's capital spending spree continues. According to the Commerce Department, U.S. businesses plan to step up plant and equipment spending this year by some 13.3 percent after inflation is netted out, compared with 1983 levels. If so, this would mark the largest year-over-year gain in real plant and equipment spending since 1966.

. . . Hits A Snag

But while the return of corporate America to the debt markets doesn't necessarily have to be harmful to corporate financial health, especially if lower cost and/or longer-term debt than presently outstanding could be accessed, in today's lofty interest rate environment it probably is. For with long-term interest rates still riveted within double-digit territory, it is hardly surprising that the lion's share of the corporate financing shortfall that emerged in the first half of this year was satisfied by either the commercial banks or in the commercial paper market. As shown in the chart on page 1, short-term business credit outstanding—the combination of commercial and industrial loans and nonfinancial company commercial paper—rose by more than $31 billion during the first half of this year. Not only was this sum almost four times the amount added during the immediately preceding six months, but it was also about twice the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	9/12/84		
U.S. Gov'ts and Agencies Owned Outright & RPs	161.680	+ .045	+ 8.208
Loans to Depository Inst.	7.503	− .504	+ 6.353
Float	.694	+ .321	− .909
Total Reserve Bank Credit	178.287	+ .053	+ 14.317
Treasury Deposits with Federal Reserve Banks	3.933	− .207	+ .495
Currency in Circulation	177.512	+ .455	+ 13.090
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	118.667	− 2.469	+ 7.612
Member Bank Reserves:	9/12/84		
Total Reserves Held	36.994	+ .736	+ 2.789
Excess (Deficiency)	.704	+ .027	+ .300
Net Free Reserves	.320	+ .279	+ .380
Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (9/3/84)	544.9	+ 2.4‡	+ 5.5‡
M2 (August '84)	2,289.1	+ 5.4	+ 7.2
M3 (August '84)	2.867.6	+ 7.3	+ 9.6
Domestic Nonfinancial Debt (2nd Q'84)	5,589.6	+ 12.9	+ 12.4

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

	3 Months	6 Months	1 Year
Offering Rates 9/14/84			
‡ U.S. Treasury Bills	9.85%	10.00%	10.15%
* Federal Agencies	11.05	11.36	11.86
* Project Notes—Taxfree (46% Taxable Equivalent)	11.02	11.20	11.48
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	11.25	11.35	11.88

‡ Finance Company Paper—Prime

5- 14 days	11.20%
15- 29 days	11.20
30- 59 days	11.15
60- 89 days	11.00
90-179 days	10.85
180-239 days	10.60
240-270 days	10.60

‡* Bankers' Acceptances

Oct.	11.35%
Nov.	11.30
Dec.	11.23
Jan.	11.23
Feb.	11.23
Mar.	11.15

‡ Industrial Paper—Prime

30- 89 days	11.08%
90-120 days	10.90

† Federal Funds Effective Rate 11.35%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'84	$ 3,648	$ 3,553	$ 3,267
Gross National Product (1972 Dollars)*	2nd Q'84	$ 1,641	$ 1,611	$ 1,525
Percent Change, Annual Rate	2nd Q'84	7.6	10.1	9.4
Change in Consumer Prices (new series)*	Jul '84	3.6%	2.4%	4.8%
Change in Producer Prices*	Aug '84n	− 1.2%	3.6%	4.8%
Civilian Employment (Thousands of Persons)†	Aug '84	104,969	105,395	101,484
Unemployment as % of Civilian Labor Force†	Aug '84	7.5%	7.5%	9.5%
Personal Income*	Jul '84	$ 3,027	$ 3,003	$ 2,745
Leading Indicators Composite Index (1967 = 100)†	Jul '84	165.3	166.6	158.2
Industrial Production Index (1967 = 100)†	Aug '84n	166.2	165.8	151.8
Net Change in Consumer Installment Credit †	Jul '84n	$ 7.11	$ 7.83	$ 3.71
U.S. Merchandise Trade Balance †	Aug '84	−$ 14.06	−$ 8.91	−$ 6.37
Plant and Equipment Expenditures*	4th Q'84n	$318.33(a)	$316.22(a)	$283.96
Private Housing Starts (Thousands of Units)*	Jul '84	1,761	1,886	1,793
New Construction Expenditures*	Jul '84	$ 311.4	$ 309.3	$ 272.3
Total Business Inventories †	Jun '84	$ 546.1	$ 545.9	$ 500.6
Total Business Sales †	Jun '84	$ 413.6	$ 412.7	$ 369.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

dollar value of new corporate bond offerings during the January-June 1984 period.

The renewed reliance on short-term debt has brought to a halt the process of lengthening the maturity structure of corporate liabilities. Fully $1 of every $2 of corporate debt is now of short-term duration—a record high. What is more, whereas the funding of short-term debt in the long-term markets continued for a full four calendar quarters following the trough of the 1973-75 recession, it did so for only half that time this time around. This inability to retire a sizable chunk of costly short-term debt provides one good reason why interest expenses alone continue to absorb more than $1 of every $4 of cash flow generated—a proportion which has been rising over the past two quarters.

While the snags encountered in mending corporate finances may bring frowns to company treasurers, shareholders at least should have something to smile about. With earnings soaring, the number of dividend reductions announced during the first six months of 1984 was about half that of the same period a year ago, while the number of dividend hikes increased 3½ percent. In fact, distributions surged to almost $80 billion in the second quarter, or 11½ percent higher than a year earlier. M

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (8/29/84)	158,036	+ 185	+ 9,107
New York City (9/5/84)	35,020	− 74	+ 2,325
Commercial Paper (9/5/84)	220,746	− 1,593	+46,756

Bank Loans

(Millions of Dollars)

Commerical and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/29/84)	242,089	− 966	+26,084
New York City (9/5/84)	64,728	+ 983	+ 6,628

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/29/84)	615,754	+ 88	+85,532
New York City (9/5/84)	141,043	+ 4,287	+21,720

Financial Markets

	Friday 9/14/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.72%	− .28	+ 1.32
180-Day Bills†	11.10	− .35	+ 1.30
Longest Bills†	11.40	− .50	+ 1.25
Recent Issues:			
12⅜s 8/31/86	12.04	− .46	
13⅜s 6/30/88	12.26	− .49	
12⅝s 8/15/94	12.27	− .48	
12½s 8/15/14	12.09	− .31	
Municipals:			
Bond Buyer—20 Bond Index* (9/13/84)	10.10%	− .08	+ .48
Blue List Total ($ Million)	$1,533	− $ 63	+ $ 499
30-Day Visible Supply ($ Million)	$4,809	+ $1,120	+ $2,848
Total	$6,342	+ $1,057	+ $3,297
Corporates:			
Moody's Aa Composite (9/13/84)	13.28%	− .14	+ .55
30-Day Visible Supply ($ Million)	$1,185	+ $535	+ $ 778
Stocks:			
Dow-Jones Averages:			
Industrials	1,237.52	+ 30.14	+ 11.81
Transportation	526.52	+ 19.11	− 46.21
Utilities	132.80	+ 3.70	+ .91
65 Stocks	480.15	+ 13.43	− 8.73
Standard and Poor's 500 Stocks	168.78	+ 4.41	+ 2.51
N.Y.S.E. Composite Index	97.05	+ 2.36	+ .88
N.Y.S.E. Avg. Daily Vol. for Week (000's)	100,768	+ 23,713	+ 19,232

* 46% Taxable equivalent 18.70%

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 9/14/84	Week Ago
Overnight	11.31%	11.50%
1 month	11.50	11.75
3 month	11.63	11.88
6 month	11.88	12.19
1 year	12.25	12.69
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	12.40%	12.50%
Long Term (7 to 15 yrs.)	12.40	12.50

FOREIGN EXCHANGE SPOT RATES

New York Opening (9/14/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01644	60.81
Canada	.7610	1.3140
Denmark	.09138	10.9430
France	.1076	9.2900
Germany	.3305	3.0255
Italy	.0005369	1862.50
Japan	.004078	245.20
Mexico	.005102	196.00
Netherlands	.2932	3.4112
Switzerland	.3997	2.5018
U.K.	1.2692	.7879

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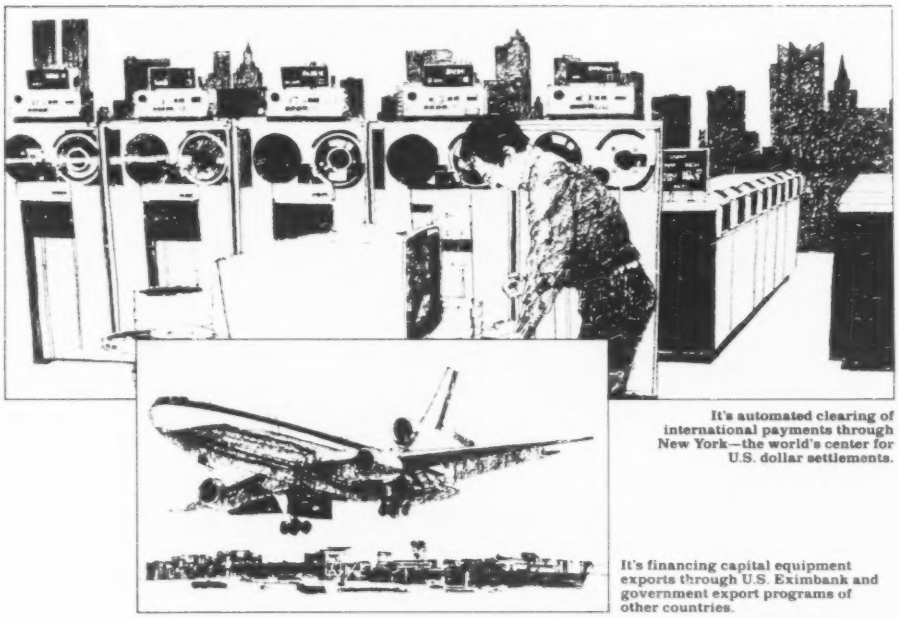

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